

## ON WAY TOWARDS A CASHLESS ECONOMY

### CHALLENGES AND OPPORTUNITIES

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#### ABSTRACT

*On the night of November Eighth, 2016 in a television address to the nation, the Hon. Prime Minister of India Mr. Narendra Modi made an announcement, informing the people that a policy has been enacted by the Government of India of demonetizing Rs 500 and Rs 1000 bank notes and thereby ceasing the usage of all • 500 and • 1,000 banknotes as legal tender in India post midnight. The drastic measure initiated by the government took the nation by surprise and was claimed by the government as a move to curb the menace of 'black money' plaguing the Indian economy. Although initially, it created a lot of hardships for the common man in form of endless lines in front of ATMs all over the country, however, it has also created opportunities towards making a transition towards a 'Cashless Economy' which is strongly being advocated and pushed by the government at all levels. As the economy makes the transition from being "cash driven" to "digitally driven", new opportunities galore both for the nation and for the young and talented. However, the path towards a truly cashless economy faces a lot of challenges as a large part of the population continues to remain outside the banking net and is not in a position to reduce its dependence on cash. Consequently the government needs to take measures both at the policy level as well as at the grassroots to make India leap towards becoming a truly cashless economy.*

**KEYWORDS:** Cashless Economy, Demonetisation, GDP & Development

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#### INTRODUCTION

Unlike the other Asian economies like Taiwan, South Korea and Singapore which are often referred to as the "Asian Tigers", the Indian economy may be considered as an 'elephant' because of its size which is huge and because of being the third largest economy in the world in purchasing power parity (PPP) terms as well as for being ponderous in its pace. In May 2014, when the new Government under Prime Minister Narendra Modi came to power, the Indian economy had gone into a tailspin as the last few years of the previous UPA regime witnessed a state of policy paralysis and corruption was deemed to be at an all time high, whilst the GDP growth was on a downwards spiral. For the initial two years after the Narendra Modi led 'National Democratic Alliance' (NDA) Government took reigns, the economy had a steady growth along with an increasing foreign direct investment (FDI). However, things took a sudden turn on the night of November Eighth, 2016, when in a television address to the nation, the Prime Minister made an announcement informing the people that a policy was enacted by the Government of India of demonetizing Rs 500 and Rs 1000 bank notes and thereby ceasing the usage of all • 500 and • 1,000 banknotes as legal tender in India post midnight<sup>1</sup>. The drastic measure initiated by the government took the

<sup>1</sup>[https://en.wikipedia.org/wiki/2016\\_Indian\\_banknote\\_demonetisation](https://en.wikipedia.org/wiki/2016_Indian_banknote_demonetisation)

nation by surprise and was claimed by the government as a move to curb the menace of 'black money' plaguing the Indian economy. Apart from other things, it also created a lot of hardships for the common man in form of endless lines in front of the ATMs all over the country in which several elderly people reportedly died whilst waiting in the long lines to take their money out from the ATMs<sup>2</sup>. Now, almost a year later post demonetization, as per the latest official data, the GDP has nosedived to 5.7 percent in the April-June quarter of 2017<sup>3</sup> which is the lowest in three years whilst sectors such as manufacturing has fallen to 1.2 percent growth, down from 10.7 percent just about a year ago<sup>4</sup>. According to reports, as many as 1.5 million jobs are already lost in the first four months of the year<sup>5</sup>. Following these reports, the government is evidently under a lot of fire from different quarters for imposing demonetization and more recently the GST without proper planning. However, the concern for this paper is not to make a political commentary either on demonetisation or GST but to focus on one of the aims stated by the Government as part of demonetization, i.e. promoting a 'cashless economy'. In simple terms, a cashless economy may be defined as one in which all the transactions are done using cards or digital means and where the circulation of physical currency is minimal<sup>6</sup>. Whilst a 'cashless transaction' refers to the electronic or digital transaction of money with the help of net-banking, credit card, etc.

## Background

One of the issues that has recently been at the forefront of the government agenda has been the promotion of a cashless economy in the country. A cashless society can be described as an economic state where most of the financial transactions are conducted through digital means which involve the transfer of digital information consisting of electronic representation of money between the concerned parties<sup>7</sup>. Although it began during the early 1990s with electronic banking getting popular in countries including the United States and countries in Western Europe, including the United Kingdom, Norway, Sweden, Denmark among others. However, it really gained pace in the last decade or so with digital payment methods being preferred by many, especially with the rise in companies like PayPal, digital wallet systems among others<sup>8</sup>. However, the penetration of digital means of payment is yet to make its presence felt in large parts across India. The Indian economy before demonetization was largely a cash based economy where about 98 percent of all consumer payments were done through cash<sup>9</sup>. Post demonetization there has been a great surge in the interest among policymakers, researchers, corporates as well as the common man to explore the advantages, hurdles and other challenges of making a shift towards a 'cashless economy' and the current paper tries to seek answers to the above mentioned issues.

<sup>2</sup>[http://www.huffingtonpost.in/2016/11/17/day-9-demonetisation-death-toll-rises-to-55\\_a\\_21608769/](http://www.huffingtonpost.in/2016/11/17/day-9-demonetisation-death-toll-rises-to-55_a_21608769/)

<sup>3</sup>[http://www.business-standard.com/article/economy-policy/gdp-growth-slows-to-5-7-in-april-june-quarter-of-fy18-117083100876\\_1.html](http://www.business-standard.com/article/economy-policy/gdp-growth-slows-to-5-7-in-april-june-quarter-of-fy18-117083100876_1.html)

<sup>4</sup><http://economictimes.indiatimes.com/news/economy/policy/demonetisation-a-boon-or-bane-for-the-indian-economy/articleshow/60846614.cms>

<sup>5</sup>India Today, September 18, 2017

<sup>6</sup><http://www.civildaily.com/story/cashless-society/>

<sup>7</sup><http://fletcher.tufts.edu/CostofCash/~media/Fletcher/Microsites/Cost%20of%20Cash/CostofCashStudyFinal.pdf>

<sup>8</sup><https://www.independent.co.uk/news/business/news/uk-moves-towards-cashless-society-10267215.html>

<sup>9</sup><http://economictimes.indiatimes.com/slideshows/economy/what-government-plans-to-do-with-the-old-rs-500-1000-notes/98-of-all-consumer-payments-in-india-use-cash/slideshow/55579468.cms>

## LITERATURE REVIEW

According to Mukhopadhyay (2016)<sup>10</sup>, 'Moody's Analytics' which is part of the Moody Corporation<sup>11</sup> and provides credit ratings, research, tools and analysis contributing to transparent and integrated financial markets, in its study of the 'impact of card usage on the gross domestic product (GDP) of 51 countries' found that electronic card usage added USD 1.1 trillion in real dollars to private consumption and GDP from 2003 to 2008. In addition, according to the report, a one percent increase in card transactions would increase consumption by 0.039% and GDP growth by 0.024% and thus, according to Mukhopadhyay (2016), similar benefits may be expected in India. In another study, according to Zandi et al. (2013), who studied 56 countries over a period of 2008-2012, calculate that \$983 billion were added to these countries' cumulative real GDP due to an increase in card usage<sup>12</sup>. Whilst Hasan et al. (2013), found that there is a positive correlation between migration from paper to electronic retail payments to the real economy. They argue that an increase of card penetration ratio in the European Union (EU) by 1.2%, would result in an increase of around 0.07% increase in the GDP<sup>13</sup>. Whilst according to Bolt et al. (2008), cashless payment instruments have the potential to save a lot of bank costs involved in handling paper money<sup>14</sup>.

On the basis of the literature reviewed as part of the study, the question which the current paper tries to focus on is how going cashless is beneficial for the Indian economy? Secondly, what are the challenges that may pose problems in making the transition from relying on paper based currency to a cashless economy and how to overcome the challenges?

### Aim of the Study

- To explore the advantages of moving from a 'cash driven' to a truly 'cashless economy'.
- To analyze the challenges and roadblocks on way towards making the transition to a 'cashless economy'.
- Explore ways to overcome the challenges and roadblocks.

## METHODOLOGY

### Research Design

It is a conceptual research study which tries to examine the advantages of a 'cashless economy' whilst trying to identify the challenges which can create problems towards making the transition from being cash-driven to a digitally driven economy. It also tries to find answers on how to make the transition as hassle free and smooth as possible whilst analysing the current scenario in the country.

### Sample

The sample includes referenced and peer reviewed articles on digital economy, and paperless payment systems as

<sup>10</sup> Mukhopadhyay, B. (2016) "Understanding Cashless Payments in India". <https://jfin-swufe.springeropen.com/track/pdf/10.1186/s40854-016-0047-4?site=jfin-swufe.springeropen.com>

<sup>11</sup> <https://www.moody.com/Pages/atc.aspx>

<sup>12</sup> Zandi M, Singh V, Irving J (2013) "The Impact of Electronic Payments on Economic Growth". <https://usa.visa.com/dam/VCOM/download/corporate/media/moodys-economy-white-paper-feb-2013.pdf>

<sup>13</sup> Hasan I, De Renzis T, Schmiedel H (2013) "Retail Payments and the Real Economy" ECB Working Paper Series, (1572). <https://www.ecb.europa.eu/pub/pdf/scpwps/ecbwp1572.pdf?0568b27871896eb01f54b0c4c40a8f63>

<sup>14</sup> Bolt W, Humphrey DB, Uittenbogaard R (2008) Transaction pricing and the adoption of electronic payments: A cross-country comparison". *Int J Central Bank* 4(1):89–123

well as newspaper reports on the threats and opportunities on way towards making India a 'cashless economy', which are reviewed as part of the study.

## FINDINGS AND DISCUSSIONS

The literature studied as part of the current paper suggests the following prominent benefits of cashless payments on GDP growth which includes:

### a). Increased Tax Collection

Unlike paper money, card payments or payments done through digital means are easy to track and thereby it becomes easier for the government agencies to keep track of people's spending and bring more people in the tax fold who were earlier not paying taxes despite having large incomes. The number of returns filed as on August 5, 2017 have registered a rise of 24.7% compared to a growth rate of 9.9% compared with last year. The total number of returns filed during the entire fiscal year 2016-17 was 5.43 crore which is 17.3% more than the returns filed during fiscal year 2015-16. For 2016-17, 1.26 crore new taxpayers were added to the tax base till June 30, 2017<sup>15</sup>.

### b) Stopping Leakages in the Public Distribution System

A cashless economy can act as an instrument to stop leakages in the 'public distribution system' in the country so that the money reaches directly in the account of the target beneficiary. In 2009, the Planning Commission estimated that only 27% of public distribution system expenditure reached the targeted low-income groups. Thus the use of digital platforms for money transfer has the potential to remove the middlemen and facilitate the intended money to reach the target beneficiary. In addition, records for payment and transactions through a digital platform is easier to maintain and keep track of which can have a significant impact on the economy as a whole in terms of efficiency, safety, and transparency.

### c). Low Costs of Storing and Processing Physical Currency

The banks have to spend a lot of time managing the paper based money in a largely cash driven economy resulting in high maintenance costs which is not the case with cards.

According to an estimate, the reserve bank of India (RBI) spent over INR 2800 crores for printing currency notes in the year 2009-10<sup>16</sup> excluding the cost incurred in the storage, transportation of the cash to ATMs as well as in its security. Given these costs, a moderate growth of cashless transactions by five percent a year will save more than INR 500 Crores annually<sup>17</sup>.

Apart from these there are many indirect benefits of promoting a cashless economy for example, "it will pave way for universal availability of banking services to all as no physical infrastructure is needed other than digital"<sup>18</sup>. In addition it will also exterminate the problem of counterfeit currency in the country whilst greatly increasing the speed of financial operations for customers because of no delays and queues in banks or in front of the ATMs.

However, apart from the advantages there are also several challenges or roadblocks on way towards making the

<sup>15</sup> <http://economictimes.indiatimes.com/news/economy/policy/demonetisation-a-boon-or-bane-for-the-indian-economy/articleshow/60846614.cms>

<sup>16</sup> <http://dspace.library.iitb.ac.in/jspui/bitstream/10054/1732/2/PaymentCardAugust31.pdf>

<sup>17</sup> <https://jfin-swufe.springeropen.com/track/pdf/10.1186/s40854-016-0047-4?site=jfin-swufe.springeropen.com>

<sup>18</sup> <http://www.civildaily.com/story/cashless-society/>

transition from a cash driven to a cashless economy which are the following:

**a). Limited Internet Connections**

According to a recent report published in “The Hindu” which is among the highly reputable English language newspapers India, “...77 lakh households out of the total 2,467 lakh households have an internet connection; that’s 3% of households”<sup>19</sup>. In addition even the internet connections that people have are pretty unevenly distributed. As per the TRAI data, urban India has 61.9 internet subscriptions per hundred people whilst rural India gets with just 13.7 per hundred<sup>20</sup>.

**b). Lack of Financial Literacy**

Although being home to 17.5% of the world’s population, nearly 76% of India’s adult population does not understand even the basic financial concepts<sup>21</sup> and consequently this extremely large chunk of populace remain on the sidelines of the government’s drive to go digital.

**c). No Law on Data Security**

Even the people who are tech savvy are wary of cashless transactions because of weak cyber laws against internet theft in India<sup>22</sup>. Just a few months ago data related to over 32 lakh debit cards were leaked from the network that connects all Indian banks.

**d). Blocked Internet**

The government routinely blocks internet in places whenever there is some major law and order problem as recently witnessed in places in Haryana during the Jat agitation. One can only imagine the scenario of what may happen when a town moves to a digital platform for transactions, but then next day finds itself cut off from the internet because the local administration decides to block the internet connection citing some law and order issue. These and many other reasons have the potential to create roadblocks in front of the government making the transition towards a cashless economy. So the government must work towards removing these bottlenecks.

**Things the Government Needs to Do**

- **Creating Awareness about the Advantages of Cashless Payments:** A concerted effort is required by the government to make the individuals aware of the advantages of cashless payments as one of the starting points<sup>23</sup>.
- **Removal of E-Payment Costs:** Merchant Discount Rates and convenience charges associated with e-payments must be reduced.
- **Increasing Financial Literacy:** This is easier said than done, however, the government must work towards creating an environment of increasing financial literacy as well as knowledge about internet from schools.

<sup>19</sup> <http://www.thehindu.com/business/how-many-indians-have-internet/article17668272.ece>

<sup>20</sup> <http://www.thehindu.com/business/how-many-indians-have-internet/article17668272.ece>

<sup>21</sup> <http://www.livemint.com/Opinion/f5xo11OSPqxGWUdaWKVb8J/Why-India-needs-to-work-on-financial-literacy-now-more-than.html>

<sup>22</sup> <http://indiatoday.intoday.in/technology/story/9-simple-reasons-why-india-cant-go-cashless-irrespective-of-whatever-pm-modi-says/1/821460.html>

<sup>23</sup> <https://jfin-swufe.springeropen.com/track/pdf/10.1186/s40854-016-0047-4?site=jfin-swufe.springeropen.com>

These and much more needs to be done to create an environment of financial and technological awareness, trust and the ease of using digital modes of transactions to encourage people to switch towards a cashless economy in a country which has the largest number of illiterate people in the world numbering 287 million which is 37 percent of the global total<sup>24</sup>.

## CONCLUSIONS

For India, the roadmap towards creating an environment of secure and a user-friendly digital payments infrastructure has the potential to immensely increase the financial inclusion of the people currently living on the fringes of the society and the development ladder and that is perhaps one of the most important reasons that the government must vigorously work towards promoting and developing a cashless economy.

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